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8 June 1970

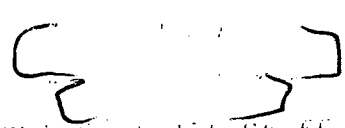
MEMORANDUM FOR: Chief, SB Division

THROUGH : Deputy Director for Plans

SUBJECT : Report of Audit of Project AERODYNAMIC
1 January 1969 to 31 December 1969

1. Attached is a copy of subject report. Please note the action recommended in paragraph 4.

2. We appreciate the cooperation given the auditor during the audit.

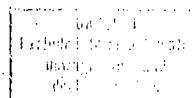

Chief, Audit Staff

Attachment

Distribution:

Orig. 1 - Chief, SB Div.
1 - GSA/DDS
1 - ExD/Comp(D/PPB)
1 - D/EIn
1 - O/IG

DECLASSIFIED AND RELEASED BY
CENTRAL INTELLIGENCE AGENCY
SOURCE METHOD EXEMPTION 3B2B
NAZI WAR CRIMES DISCLOSURE ACT
DATE 2007



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AUDIT STAFF REPORT OF AUDIT

This report presents the findings developed from an audit undertaken pursuant to Audit Staff responsibilities and authorities set forth in organization regulations. Unless otherwise indicated in the report, the audit included review and appraisal of internal controls and procedures and such other audit processes, test checks and verification of accounts, assets and transactions as were considered appropriate and consistent with generally accepted audit standards in the circumstances.

The objectives of the audit were to determine for management whether

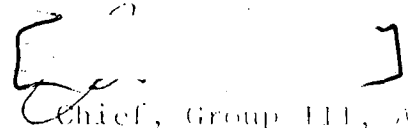
- (1) Adequate controls and procedures have been established and are being applied effectively to safeguard organization resources and assure that resources are used only for approved and legal purposes, and
- (2) Activities are being conducted economically, efficiently and in conformance with policy determinations and directives.

Project AERODYNAMIC

For the period:

From 1 January 1969

Through 31 December 1969


Chief, Group III, Audit Staff

Date 8 June 1970

This report consists of 9 page(s).

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GROUP 1
Excluded from automatic
downgrading and
declassification

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REPORT OF AUDIT
Project AERODYNAMIC

For the Period
1 January 1969 to 31 December 1969

BACKGROUND

1. Subsidy Project AERODYNAMIC consists of (1) an Agency-owned corporation AETENURE which is a WOLADY based emigre political group organized as a commercial taxable enterprise ostensibly servicing contracts for unspecified users and (2) a Munich group, AETERRACE which since the MIDOWEL incident originates most of the project publications abroad. The project provides for the exploitation and expansion of an anti-Soviet resistance movement through publications and through contacts with Soviet citizens.

2. Our audit included an examination of the AETENURE cover company financial records, procedures, and controls and a review of related Headquarter's records, controls and procedures. For security reasons we did not audit the expenditures of AETERRACE and have relied on the case officer's knowledge of the operations and production of AETERRACE to determine that the expenditures appeared valid and reasonable. If security permits, Division should consider the desirability of acquiring a Certified Public Accountant's (or Chartered Accountant's) report on this phase of the project.

SUMMARY OF FINANCIAL INFORMATION

3. The Agency investment in AETENURE at 31 December 1969 totaled [] AETENURE recorded income and receipts from clients in the amount of \$132,912 of which \$17,331 was fictitious income, \$28 was legitimate income and [] was funded by JKLANCE. The expenses totaled \$138,763. Additional financial details are contained in Exhibits A and B attached. The Agency investment in AETERRACE at 31 December 1969 totaled \$ [] AETERRACE reported income of \$12,609 of which [] advanced in prior period

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and received during 1969) was funded by JKLANCE. The expenses totaled \$67,194.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

4. Records, procedures and internal controls were satisfactory except that certain transactions and the internal administration of the project needs to be better documented. It appears that the project has been utilizing funds for project expenses that should have been retained for or paid into the employees pension trust. More direction from Headquarters on administrative matters is needed. Recommendations resulting from this audit are summarized below and detailed in the referenced paragraphs.

- a. Monitor the cash position and the expenditures of the cover company to prevent the project from over-expenditure of funds. (Paragraph 5)
- b. Liquidate the liability of \$10,358 to the employee's pension trust so as to present a better financial position on the financial statements of the project. (Paragraph 5)
- c. Obtain guidance to assist the employees of the project in managing the trust fund. (Paragraph 6)
- d. Provide new contracts for the project that would better substantiate the current funding of the project. (Paragraph 7)
- e. Have project prepare letters and documents to indicate that all supporting documentation to the research (covert) expenditures on behalf of the ostensible clients have been sent to the client. (Paragraph 8)

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- f. Give more direction to the project on how much profit or loss the project should reflect on its records. (Paragraph 9)
- g. Determine the continued necessity and reason for the \$6,000 yearly payment to the head of AETERRACE. (Paragraph 10)
- h. Charge all ticket purchases to the advance accounts of the employees, to be accounted for upon completion of travel. (Paragraph 11)
- i. Have project officials execute overt documents to authorize the salaries of project personnel. (Paragraph 12)

Cover Company has Overexpended
Its Funds

5. The project records as of 31 December 1969 reflect a liability to the employees pension trust in the amount of \$10,358 yet their cash position at that date was only \$925. It appears the cover company has been using cash that should have gone to the employees pension trust for other project expenses. The payment of this liability without special funding will reduce the funds available for project expenses during the forthcoming year but provision should be made for its liquidation.

Recommendation: We recommend that SB Division closely monitor the cash position and the expenditures of the cover company to prevent future overexpenditures of funds. We further recommend that the liability of \$10,358 be liquidated from the project records by transferring the funds to the trust so as to present a better financial position on the financial statements of the project. In the future the funds should be transferred to the trust on a regular basis.

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Employees Pension Trust Needs
Professional Guidance

6. The employees pension fund as of 31 December 1969 reflects an unrealized loss of \$6,795 on the \$62,303 that has been invested since 1961 and a \$10,358 receivable from the project. We feel more professional guidance is needed for the trust which is managed by the employees. Evidence of this is the \$10,358 receivable which the trust allowed to accumulate without investing it in an income producing bank account or treasury note and the unrealized loss of \$6,795 in the trust after almost nine years of operation. We do not feel that the trust will adequately provide for the employees that are approaching retirement age. The trust as it is now operated will probably provide lump sum payments upon retirement whereas investments providing a monthly income upon retirement might be more suitable.

Recommendation: We recommend that SB Division seek advice from the Office of Personnel in managing the trust fund.

Documentation Needed To
Substantiate Funding

7. Currently the project is receiving JKLANCE funding through two fixed-fee contracts from firms provided by the Central Cover Staff. At the project's discretion Agency funds are segregated into an income and/or a liability account (clients funds). Ostensibly the clients funds are funds advanced by the client to the project for research work. Actually the project uses these funds to accomplish the covert activities of the project. The fixed-fee contracts provided by the Cover Staff do not provide for the advance of funds for research work, nor is there any other documentation to support the receipt of client's funds

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for research. An outside audit from Internal Revenue or New York might result in an adjustment of the funds, currently recorded as a liability, to income. Such adjustment might result in additional tax as well as questioning of the project's operations.

Recommendation: We recommend that new contracts be provided that would better substantiate the current funding of the project.

Expenditures Are Poorly Supported

8. The covert project expenses totaling \$30,860 (see Exhibit B) which are overtly carried on the project's records as research expenses on behalf of their clients, are poorly supported. In many instances the expenditure is supported only by a cancelled check made payable to an individual. Accountings often lack necessary explanations that would be normal in business practice. Petty cash vouchers are poorly explained and sometimes not signed.

Recommendation: We recommend quarterly letters be prepared to indicate that the project has sent to its client statements of its ostensible research expense with all supporting documentation. This might keep unwitting personnel from Internal Revenue, New York State and City from questioning the covert activities of the project. We further recommend that accountings be better documented with names, purposes and business like explanations and that the support to the ostensible research expenditures be retained at the project for Audit Staff review.

Headquarters Direction Needed

9. The project decides when and how much of the Agency funds are to be applied to income and liability and establishes a fictitious year end receivable to increase its profit to enable it to regulate the amount of loss or profit reflected on its records.

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Recommendation: We recommend that the SB Division give the project more direction on how much profit or loss the project should show on their records each year.

No Authority For Continuing Payment

10. Included in representatives expense is \$6,000 paid to an individual residing in Rome who we were informed heads AETERRACE. We could find no authority for this payment and could not determine what services were being provided by this individual for the \$6,000 payment he receives each year.

Recommendation: We recommend that SB Division determine the continued necessity and reason for this \$6,000 yearly payment.

Tickets For Travel Not Accounted For

11. Tickets purchased for travel by project personnel are charged to expense at the time of purchase.

Recommendation: We recommend that at the time of purchase all tickets be charged to the advance account of the applicable individual until accounted for upon completion of the travel.

Documentation Needed In Project To Authorize Salaries

12. We found no authority within the project that establishes the salaries or documents the raises of project personnel.

Recommendation: We recommend that SB Division have project officials execute overt documents to authorize the salaries of project personnel.

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Exhibit A

AERODYNAMIC/AETENURE

Statement of Financial Condition
1 January 1969 - 31 December 1969

Assets

Cash on hand and in bank.....	\$	925
Cash in unrecorded Switzerland bank.....	a/	25,016
Fixed assets.....	\$	4,317
Less:		
Accumulated depreciation.....		<u>1,023</u> 3,294
Deposits.....		<u>352</u>
Total assets.....		<u>\$29,587</u>

Liabilities

Taxes payable.....	\$	1,578
Accounts payable.....		223
Employees pension plan payable.....		<u>10,358</u>
		12,159
Investment, 1 January 1969.....	\$	65,641
Advances received from Agency.....		<u>115,550</u>
		181,191
Transfers to AETERRACE.....		<u>25,000</u>
		156,191
Net expenses - Exhibit B.....		<u>138,763</u> b/ <u>17,428</u>
Total liabilities.....		<u>\$29,587</u>

a/ This amount of \$25,016 refunded to Agency
subsequent to audit date.

b/ Recorded on overt records:

Capital stock.....	\$20,000
Retained earnings (deficit)	(12,902)
Client's funds.....	2,643
Accounts receivable.....	<u>(17,334)</u> \$(7,588)
Plus: Unrecorded Switzerland bank account.....	<u>25,016</u>

\$17,428

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Exhibit B

AERODYNAMIC/AETENURE

Statement of Net Expense
1 January 1969 - 31 December 1969

Administrative Expenses

Payroll and personnel benefits.....	\$86,200
Travel.....	8,455
Taxes.....	4,457
Rent.....	2,956
Telephone.....	1,611
Stationery and supplies.....	1,018
Postage.....	884
Books.....	753
Depreciation.....	513
Light.....	288
Entertainment.....	155
Miscellaneous.....	641

Total administrative expenses..... \$107,931

Covert Project Expenses

Representatives.....	\$ 8,208
Travel.....	5,577
Books.....	2,594
Photocopying and duplicating.....	2,503
Interviews.....	2,178
Bulletin distribution.....	1,775
Affiliated groups.....	1,772
Package mailing program.....	1,667
Book distribution.....	301
Bulletin cost.....	585
Gifts.....	255
Miscellaneous.....	a/ 2,945

Total covert project expenses..... 30,860

Total expenses..... \$138,791

Less:

Outside income..... 28

Net expenses - Exhibit A..... \$138,763

a/ Includes \$46 in adjustments on the
unrecorded Swiss bank account.

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Exhibit B - Page 2

AERODYNAMIC/AETENURE

Statement of Net Expense
1 January 1969 - 31 December 1969

Reconciliation

Net expenses (page 1).....		\$138,763
Less:		
Covert expenses recorded as research		
expenses on behalf of client.....	\$30,814	
JKLANCE funding recorded as income..	86,000	
Fictitious income.....	17,334	
Bank charges on unrecorded		
Switzerland bank.....	46	134,860
		\$ 3,903
Plus:		
Outside income recorded as a		
liability in client's funds.....		28
Deficit per cover company records.....		\$ 3,931

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